

**THE UNIVERSITY OF CHICAGO**

Consolidated Financial Statements and  
Supplemental University Information

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

## THE UNIVERSITY OF CHICAGO

### Management Responsibility for Financial Statements

The management of The University of Chicago (University) is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements. The financial statements, presented on pages 3 to 32, have been prepared in conformity with generally accepted accounting principles and, as such, include amounts based on judgments and estimates by management.

The consolidated financial statements have been audited by the independent accounting firm KPMG LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of trustees. KPMG did not audit the financial statements of The University of Chicago Hospitals (Hospitals) and their opinion, insofar as it relates to the amounts included for the Hospitals, is based solely on the report of PricewaterhouseCoopers, the independent auditors for the Hospitals. The University believes that all representations made to KPMG during its audit were valid and appropriate. KPMG's audit opinion is presented on page 2.

The University maintains a system of internal controls over financial reporting, which is designed to provide reasonable assurance to the University's management and Board of Trustees regarding the preparation of reliable published financial statements. Such controls are maintained by the establishment and communication of accounting and financial policies and procedures, by the selection and training of qualified personnel, and by an internal audit program designed to identify internal control weakness in order to permit management to take appropriate corrective action on a timely basis. There are, however, inherent limitations in the effectiveness of any system of internal control, including the possibility of human error and the circumvention of controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statement preparation.

The Trustees of The University of Chicago, through its Audit Committee comprised of trustees not employed by the University, are responsible for engaging the independent accountants and meeting with management, internal auditors, and the independent accountants to ensure that each is carrying out their responsibilities. Both internal auditors and the independent accountants have full and free access to the Audit Committee.



Donald J. Reaves  
Vice President for Administration  
and Chief Financial Officer.



William J. Hogan, Jr.  
Comptroller



KPMG LLP  
303 East Wacker Drive  
Chicago, IL 60601-5212

## Independent Auditors' Report

The Board of Trustees  
The University of Chicago:

We have audited the accompanying consolidated balance sheets of The University of Chicago (the University) as of June 30, 2006 and 2005, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of The University of Chicago Hospitals (the Hospitals), which statements reflect total assets constituting 15% and 15% and total revenue constituting 30% and 32% of the related consolidated totals in 2006 and 2005, respectively. Our opinion, insofar as it relates to the amounts included for the Hospitals, is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Chicago as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information presented in the University and Hospitals columns on pages 3 through 6 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, based on our audits and with respect to the amounts included for the Hospitals, the report of other auditors, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole. In addition, the supplementary information included in schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

**KPMG LLP**

September 19, 2006

**THE UNIVERSITY OF CHICAGO**

Consolidated Statements of Activities

June 30, 2006 and 2005

(In thousands of dollars)

	2006			2005
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:				
Operating:				
Revenue:				
Tuition and fees – gross	\$ 445,960	—	445,960	420,361
Less:				
Undergraduate student aid	(51,847)	—	(51,847)	(46,329)
Graduate student aid	(134,808)	—	(134,808)	(128,317)
Tuition and fees – net	259,305	—	259,305	245,715
Government grants and contracts	317,773	—	317,773	305,291
Private gifts, grants, and contracts	105,807	698	106,505	93,080
Endowment payout	176,648	6,877	183,525	183,914
Earnings on other investments	7,044	14,753	21,797	25,276
Patient care	175,569	795,273	970,842	945,735
Auxiliaries	168,770	—	168,770	160,725
Other income	122,521	44,286	166,807	131,689
Net assets released from restriction:	44,923	—	44,923	29,397
Total operating revenue	1,378,360	861,887	2,240,247	2,120,822
Expenses:				
Compensation:				
Academic salaries	344,814	—	344,814	330,129
Staff salaries	333,506	364,129	697,635	623,459
Benefits	191,919	75,430	267,349	223,834
Total compensation	870,239	439,559	1,309,798	1,177,422
Other operating expenses:				
Utilities, alterations, and repairs	43,113	22,492	65,605	59,772
Depreciation	84,545	46,647	131,192	121,068
Interest	34,354	13,994	48,348	36,283
Supplies, services, and other	334,665	279,153	613,818	577,584
Insurance	35,355	25,380	60,735	49,882
Total other operating expenses	532,032	387,666	919,698	844,589
Total operating expenses	1,402,271	827,225	2,229,496	2,022,011
Excess (deficiency) of operating revenue over expenses	\$ (23,911)	34,662	10,751	98,811

**THE UNIVERSITY OF CHICAGO**

Consolidated Statements of Activities

June 30, 2006 and 2005

(In thousands of dollars)

	2006			2005
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:				
Nonoperating:				
Investment gains	\$ 561,219	39,322	600,541	454,215
Minimum pension liability adjustment	70,432	7,607	78,039	(78,903)
Loss on debt refinancing	—	—	—	(8,998)
Other, net	27,803	(9,588)	18,215	(15,706)
Cumulative effect of the change in accounting for asset retirement obligations	(70,056)	(7,939)	(77,995)	—
Change in unrestricted net assets from nonoperating activities	589,398	29,402	618,800	350,608
Increase in unrestricted net assets	565,487	64,064	629,551	449,419
Changes in temporarily restricted net assets:				
Private gifts	97,001	41,712	138,713	78,930
Endowment payout	286	—	286	285
Investment gains	1,936	—	1,936	3,556
Other, net	(31,325)	(7,106)	(38,431)	(23,779)
Net assets released from restrictions	(44,923)	—	(44,923)	(29,397)
Increase in temporarily restricted net assets	22,975	34,606	57,581	29,595
Changes in permanently restricted net assets:				
Private gifts	42,053	159	42,212	44,086
Endowment payout	1,853	—	1,853	1,728
Investment gains	3,837	—	3,837	2,343
Other, net	25,482	—	25,482	6,537
Increase in permanently restricted net assets	73,225	159	73,384	54,694
Increase in net assets	661,687	98,829	760,516	533,708
Net assets at beginning of year	4,628,497	576,923	5,205,420	4,671,712
Net assets at end of year	\$ 5,290,184	675,752	5,965,936	5,205,420

See accompanying notes to consolidated financial statements.

**THE UNIVERSITY OF CHICAGO**

Consolidated Balance Sheets

June 30, 2006 and 2005

(In thousands of dollars)

Assets	2006			2005
	University	Hospitals	Consolidated	Consolidated
Cash and cash equivalents	\$ —	21,726	21,726	47,948
Notes and accounts receivable	209,725	109,911	319,636	341,841
Collateral held for securities loaned	539,719	—	539,719	571,734
Prepaid expenses and other assets	27,190	52,337	79,527	75,198
Pledges receivable	184,549	27,146	211,695	181,773
Investments	5,264,022	612,265	5,876,287	5,162,755
Land, buildings, equipment, and books	1,300,562	497,344	1,797,906	1,689,974
Total assets	\$ 7,525,767	1,320,729	8,846,496	8,071,223
<b>Liabilities and Net Assets</b>				
Liabilities:				
Accounts payable and accrued expenses	\$ 207,120	258,594	465,714	491,441
Deferred revenue	76,703	—	76,703	73,728
Payable under securities loan agreements	539,719	—	539,719	571,734
Assets held in custody for others	31,199	—	31,199	27,347
Self-insurance liability	170,600	6,934	177,534	169,249
Asset retirement obligation	69,200	7,939	77,139	—
Notes and bonds payable	1,103,978	371,510	1,475,488	1,492,782
Refundable U.S. Government student loan funds	37,064	—	37,064	39,522
Total liabilities	2,235,583	644,977	2,880,560	2,865,803
Net assets:				
Unrestricted	4,004,574	599,411	4,603,985	3,974,434
Temporarily restricted	351,993	70,525	422,518	364,937
Permanently restricted	933,617	5,816	939,433	866,049
Total net assets	5,290,184	675,752	5,965,936	5,205,420
Total liabilities and net assets	\$ 7,525,767	1,320,729	8,846,496	8,071,223

See accompanying notes to consolidated financial statements.

**THE UNIVERSITY OF CHICAGO**  
Consolidated Statements of Cash Flows  
Years ended June 30, 2006 and 2005  
(In thousands of dollars)

	<b>2006</b>			<b>2005</b>
	<b>University</b>	<b>Hospitals</b>	<b>Consolidated</b>	<b>Consolidated</b>
Cash flows from operating activities:				
Increase in net assets	\$ 661,687	98,829	760,516	533,708
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Depreciation	84,545	46,647	131,192	121,068
Loss on debt refinancing	—	—	—	8,998
Loss on disposal of land, buildings, equipment, and books	947	197	1,144	3,828
Net gain on investments	(667,876)	(2,248)	(670,124)	(548,687)
Private gifts and grants restricted for long-term investment	(139,054)	(41,871)	(180,925)	(123,009)
Other nonoperating changes	40,395	(26,883)	13,512	50,227
Minimum pension liability adjustment	(70,432)	(7,607)	(78,039)	78,903
Cumulative effect of the change in accounting for asset retirement obligations	70,056	7,939	77,995	—
Changes in assets and liabilities:				
Notes and accounts receivable	494	(740)	(246)	(21,743)
Prepaid expenses and other assets	(1,316)	1,571	255	2,492
Accounts payable and other liabilities	28,772	17,876	46,648	47,894
Self-insurance liability	8,589	(304)	8,285	15,182
Total adjustments	(644,880)	(5,423)	(650,303)	(364,847)
Net cash provided by operating activities	16,807	93,406	110,213	168,861
Cash flows from investing activities:				
Purchase of investments	(598,409)	(169,230)	(767,639)	(1,372,380)
Proceeds from sale of investments	681,128	87,741	768,869	1,203,146
Acquisition of land, buildings, equipment, and books	(161,322)	(77,851)	(239,173)	(297,310)
Loans disbursed	(63,303)	—	(63,303)	(65,584)
Principal collected on loans	85,754	—	85,754	56,977
Net cash used in investing activities	(56,152)	(159,340)	(215,492)	(475,151)
Cash flows from financing activities:				
Proceeds from issuance of notes and bonds payable	272,448	29,000	301,448	714,122
Principal payments on notes and bonds payable	(311,201)	(7,306)	(318,507)	(459,610)
Proceeds from private gifts and grants restricted for long-term investment	118,493	32,510	151,003	100,600
Other nonoperating changes	(40,395)	(14,492)	(54,887)	(52,357)
Net cash provided by financing activities	39,345	39,712	79,057	302,755
Decrease in cash and cash equivalents	—	(26,222)	(26,222)	(3,535)
Cash and cash equivalents at:				
Beginning of year	—	47,948	47,948	51,483
End of year	\$ —	21,726	21,726	47,948
Supplemental disclosure of cash flow information:				
Cash paid for interest	\$ 45,668	13,100	58,768	50,408

See accompanying notes to consolidated financial statements.

# THE UNIVERSITY OF CHICAGO

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

### (1) Summary of Significant Accounting Policies

#### *Description of Business*

The University of Chicago (the University) is a private, nondenominational, coeducational institution of higher learning and research. The University provides education and training services, primarily for students enrolled in undergraduate, graduate, and professional degree programs, and performs research, training, and other services under grants, contracts, and other agreements with sponsoring organizations, including both government agencies and private enterprises. Certain members of the University's faculty also provide professional medical services to patients at The University of Chicago Hospitals (the Hospitals) and other health care facilities located in the area.

Significant accounting policies followed by the University and the Hospitals are set forth below. Accounting policies specific to the Hospitals are discussed in note 2.

#### *Basis of Presentation*

The consolidated financial statements of the University have been prepared on the accrual basis and include the accounts of the University and the Hospitals. The organization of the Hospitals and agreements between the University and the Hospitals are discussed in note 2.

The University maintains its accounts in accordance with the principles of fund accounting. Under this method of accounting, resources for various purposes are classified into funds that are in accordance with activities or objectives specified by donors. Separate accounts are maintained for each fund.

For reporting purposes, however, the University follows the reporting requirements of Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations* (SFAS No. 117). SFAS No. 117 requires that resources be classified for reporting purposes based on the existence or absence of donor-imposed restrictions. This is accomplished by classification of fund balances into three classes of net assets – unrestricted, temporarily restricted, and permanently restricted. Descriptions of the three net asset categories and the types of transactions affecting each category follow:

- Unrestricted – net assets that are not subject to donor-imposed restrictions. Items that affect this net asset category principally consist of fees for service and related expenses associated with the core activities of the University – instruction, conduct of sponsored research, and provision of health care services. In addition to these exchange transactions, changes in this category of net assets include investment return on endowment funds, actuarial adjustments to self-insurance liabilities, and certain types of philanthropic support. Such philanthropic support includes unrestricted gifts, including those designated by the Board to function as endowment and restricted gifts whose donor-imposed restrictions were met during the fiscal year, as well as restricted gifts and grants for buildings and equipment that have been amortized over the useful life of the assets acquired or constructed.



# THE UNIVERSITY OF CHICAGO

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

- Temporarily Restricted – net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time. Items that affect this net asset category are gifts for which donor-imposed restrictions have not been met, gifts and grants for buildings and equipment, annuity and life income gifts, pledges for which the ultimate purpose of the proceeds is not permanently restricted, and endowments where the principal may be expended upon the passage of a stated period of time (term endowments). Expirations of restrictions on temporarily restricted net assets, including amortization of restricted gifts and grants for buildings and equipment, are reported as net assets released from restrictions.
- Permanently Restricted – net assets subject to donor-imposed restrictions to be maintained permanently by the University. Items that affect this net asset category include gifts and pledges wherein donors stipulate that the corpus be held in perpetuity (primarily gifts for endowment and providing loans to students) and only the income be made available for program operations, and annuity and life income gifts for which the ultimate purpose of the proceeds is permanently restricted.

Net assets consisted of the following at June 30:

Detail of Net Assets	2006			Total	2005 Total
	Unrestricted	Temporarily restricted	Permanently restricted		
University:					
Operating	\$ 71,428	14,448	—	85,876	99,852
Pledges	—	134,598	49,951	184,549	163,988
Student loans	—	—	14,568	14,568	13,713
Endowment	3,793,857	29,692	838,737	4,662,286	3,958,624
Annuity and life income	—	13,859	30,361	44,220	43,065
Net investment in physical properties	139,289	159,396	—	298,685	349,255
Subtotal	<u>4,004,574</u>	<u>351,993</u>	<u>933,617</u>	<u>5,290,184</u>	<u>4,628,497</u>
Hospitals:					
Operating	294,340	43,756	—	338,096	287,419
Pledges	—	26,769	377	27,146	17,785
Endowment	172,189	—	5,439	177,628	155,315
Net investment in physical properties	132,882	—	—	132,882	116,404
Subtotal	<u>599,411</u>	<u>70,525</u>	<u>5,816</u>	<u>675,752</u>	<u>576,923</u>
Total	<u>\$ 4,603,985</u>	<u>422,518</u>	<u>939,433</u>	<u>5,965,936</u>	<u>5,205,420</u>

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

*Operations*

Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing unrestricted net assets except those items associated with long-term investment, actuarial adjustments to self-insurance liabilities, and other infrequent gains and losses.

As discussed in note 12, based primarily on participation, the University and Hospitals share equally in contributions made to the defined benefit pension plan. For financial reporting purposes the Hospitals recognizes its share of annual contributions to the plan as expense. If the fiscal 2006 pension expense of \$41,495 was allocated based on plan participation, the University excess (deficiency) of operating revenue over expenses and increase in net assets in the consolidated statement of activities would increase by \$15,747 with a corresponding decrease in the Hospitals excess (deficiency) of operating revenue over expenses and increase in net assets.

As discussed in note 2, the Hospitals provides certain operating support to the University's Biological Sciences Division. Such support is included in other operating income by the University to the extent expended for noncapital purposes during the period, and amounted to \$17,512 in fiscal 2006 and \$14,373 in fiscal 2005.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

***Tuition and Fees***

Student tuition and fees are recorded as revenue during the year the related academic services are rendered. Student tuition and fees received in advance of services to be rendered are recorded as deferred revenue.

***Gifts, Grants, and Contracts***

Gifts, including unconditional pledges, are recognized in the appropriate category of net assets in the period received. Contributions of assets other than cash are recorded at their estimated fair value at date of gift. Pledges receivable are stated at the estimated net present value, net of an allowance for uncollectible amounts. Conditional promises to give are not recognized until the conditions on which they depend are substantially met.

Revenue from government and private grant and contract agreements is recognized as it is earned through expenditure in accordance with the agreements. Any funding received in advance of expenditure is recorded as deferred revenue on the consolidated balance sheets. Included in deferred revenue at June 30, 2006 and 2005 are \$42,733 and \$40,731, respectively, of private grant and contract receipts which have not been expended.

Private gifts, grants, and contracts operating revenue for fiscal years 2006 and 2005 consists of the following:

	<b>2006</b>			<b>2005</b>
	<u>University</u>	<u>Hospitals</u>	<u>Total</u>	<u>Total</u>
Private gifts:				
Unrestricted as to use	\$ 15,297	698	15,995	17,447
Temporarily restricted gifts whose restrictions were met during the fiscal year and reported as unrestricted revenue	35,634	—	35,634	21,802
Private grants and contracts	<u>54,876</u>	<u>—</u>	<u>54,876</u>	<u>53,831</u>
Total	<u>\$ 105,807</u>	<u>698</u>	<u>106,505</u>	<u>93,080</u>

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

***Endowment Payout***

The University utilizes the total return concept in allocating endowment income. In accordance with the University's total return objective, between 4.5% and 5.5% of a twelve quarter moving average of the fair value of endowment investments, lagged by one year, is available each year for expenditure in the form of endowment payout. The exact payout percentage, which is set each year by the Board of Trustees with the objective of a 5% average payout over time, was 5.15% and 5.1% for the fiscal years ended June 30, 2006 and 2005, respectively.

If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

Endowment payout for fiscal years 2006 and 2005 consists of the following:

	2006			2005
	University	Hospitals	Total	Total
Interest, dividends, and rents	\$ 77,903	2,929	80,832	80,790
Realized investment gains used to support the endowment payout formula	100,884	3,948	104,832	105,137
Total	\$ 178,787	6,877	185,664	185,927

Unrestricted operating endowment payout revenue for fiscal years 2006 and 2005 consists of the following:

	2006			2005
	University	Hospitals	Total	Total
Unrestricted payout	\$ 47,393	6,877	54,270	55,398
Temporarily restricted payout whose restrictions were met during the fiscal year and reported as unrestricted revenue	129,255	—	129,255	128,516
Total	\$ 176,648	6,877	183,525	183,914

# THE UNIVERSITY OF CHICAGO

## Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

### *Patient Care*

Net patient service revenue reflects the estimated net realizable amounts due from third-party payors for services rendered. A majority of patient care revenue is derived from contractual agreements with Medicare, Medicaid, Blue Cross/Blue Shield, managed care, and certain other programs. Payments under these agreements and programs are based on specific amounts per case or contracted prices. Certain revenue received from third-party payors is subject to audit and retroactive adjustment. Any changes in estimates under these contracts are recorded in operations currently.

### *Cash Equivalents*

Cash equivalents include U.S. Treasury notes, commercial paper, and corporate notes with original maturities of three months or less, except that such instruments purchased with endowment assets or funds on deposit with bond trustees are classified as investments.

### *Investments*

Investments are recorded in the consolidated financial statements at fair value. The fair value of investments is based on quoted market prices, except for certain alternative investments, such as private equity, real assets, and absolute return, for which quoted market prices may not be available. The estimated fair value for absolute return, private equity, and real asset investments is based on valuations provided by the external investment managers. The valuations for these alternative investments necessarily involve estimates, appraisals, assumptions, and methods which are reviewed by the University's Investment Office.

The University does not engage directly in unhedged speculative investments; however, the board of trustees has authorized derivative investments to gain market exposure within asset class ranges, hedge nondollar investments and currencies, and provide for defensive portfolio strategies. To minimize the risk of loss, hedge fund investments are diversified by strategy, external manager, and number of positions. In addition, the activities of all hedge fund managers are regularly reviewed by their independent outside auditors and the University Investment Office. The risk of any derivative exposure is limited to the amount invested with each manager. Derivative investments are recorded at fair value and valuation gains and losses are included in the consolidated statements of activities.

### *Land, Buildings, Equipment, and Books*

Land, buildings, equipment, and books are generally stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets.

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

#### *Split Interest Agreements*

The University's split interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the University serves as trustee. Assets held in these trusts are included in investments. Contribution revenue is recognized at the dates the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the trusts for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits.

#### *Use of Estimates*

The preparation of financial statements in accordance with generally accepted accounting principles requires that management make a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the balance sheet date, and the reporting of revenue, expenses, gains, and losses during the period. Actual results may differ from those estimates.

#### *Reclassifications*

Certain 2005 amounts have been reclassified to conform to the 2006 presentation.

### (2) **The University of Chicago Hospitals**

#### *Organization*

The University of Chicago Hospitals was incorporated and assumed the operations of the University hospitals and clinics on October 1, 1986. The University of Chicago Hospitals also includes QV, Inc., an affiliated not-for-profit health care corporation operating clinics in the Chicago area. The University, as the sole corporate member of the Hospitals, elects the Hospitals' Board of Trustees.

#### *Agreements with the University*

The relationship between the University and the Hospitals is defined in an Affiliation Agreement and an Operating Agreement, both dated October 1, 1986. The Operating Agreement was amended and a Lease Agreement between the University and the Hospitals was entered into as of June 30, 1987. Additional lease agreements have been entered into from time to time. The Affiliation Agreement specifies University and Hospitals' responsibilities for the provision of patient care, teaching, and research at the hospitals and clinics. The Operating Agreement provides for the management and operation by the Hospitals of the University's hospital and clinic facilities. The Lease Agreement provides a leasehold interest in the University health care facilities and certain land and parking structures.

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

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(In thousands of dollars)

#### ***Basis of Presentation***

The Hospitals maintains its accounts and prepares stand-alone financial statements in conformity with accounting and reporting principles of the American Institute of Certified Public Accountants *Audit and Accounting Guide Health Care Organizations*. For purposes of presentation of the Hospitals' financial position and changes in net assets in the consolidated financial statements, several reclassifications have been made as follows: (1) the provision for uncollectible Hospitals' patient accounts receivable of \$44,236 in fiscal year 2006 and \$50,947 in fiscal year 2005 has been reclassified as a reduction of patient care revenue and (2) realized investment gains of \$37,074 in fiscal year 2006 and \$10,570 in fiscal year 2005 not used for operations have been reclassified as a nonoperating change in unrestricted net assets.

The Hospitals have made certain commitments to support the enhancement and expansion of several programs within the University's Biological Sciences Division. During fiscal 2006 and fiscal 2005, the Hospitals transferred \$15,000 annually to the University in support of these programs.

### **(3) Investments**

Fair values of investments at June 30, 2006 and 2005 are shown below:

	2006				2005 Total
	University and Hospitals endowment	Other investments		Total	
		University	Hospitals		
Cash equivalents	\$ 16,154	1,570	1,407	19,131	23,249
Domestic public equities	644,067	47,048	232,847	923,962	1,158,528
International public equities	1,258,238	25,340	2,037	1,285,615	761,523
Private equity	586,687	3,314	19,241	609,242	679,489
Real assets	558,356	14,333	6,011	578,700	355,582
Absolute return	1,303,516	7,362	—	1,310,878	731,560
High yield bonds	—	441	—	441	203,963
Fixed income	448,172	169,060	154,403	771,635	837,810
Funds held in trust (primarily cash equivalents and bonds)	24,724	333,268	18,691	376,683	411,051
Total	\$ 4,839,914	601,736	434,637	5,876,287	5,162,755

The University is obligated under certain limited partnership investment fund agreements to advance additional funding periodically up to specified levels. At June 30, 2006, the University had unfunded commitments of \$1,162,134 which are likely to be called through 2012.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

Changes in the fair value of endowment investments were as follows for the fiscal years ended June 30, 2006 and 2005:

	<b>2006</b>			<b>2005</b>
	<b>University</b>	<b>Hospitals</b>	<b>Consolidated</b>	<b>Consolidated</b>
Investment return:				
Endowment yield (interest, dividends, and rents)	\$ 77,903	2,929	80,832	80,790
Realized gains on investments	421,494	16,324	437,818	354,326
Unrealized gains on investments	245,091	9,795	254,886	201,669
Total investment return	744,488	29,048	773,536	636,785
Endowment payout	(178,787)	(6,877)	(185,664)	(185,927)
Net investment return	565,701	22,171	587,872	450,858
Other changes in endowment investments:				
Gifts and pledge payments received in cash	64,284	142	64,426	50,948
Transfers to create funds functioning as endowment	71,133	—	71,133	9,828
Other changes	2,544	—	2,544	1,791
Total other changes in endowment investments	137,961	142	138,103	62,567
Net change in endowment investments	703,662	22,313	725,975	513,425
Endowment investments at:				
Beginning of year	3,958,624	155,315	4,113,939	3,600,514
End of year	\$ 4,662,286	177,628	4,839,914	4,113,939



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Notes to Consolidated Financial Statements

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**(4) Notes and Accounts Receivable**

Components of notes and accounts receivable at June 30, 2006 and 2005 are shown below:

	<b>2006</b>		<b>2005</b>	
	<b>University</b>	<b>Hospitals</b>	<b>University</b>	<b>Hospitals</b>
Patients	\$ 106,275	145,036	103,145	147,931
Students:				
Loans	106,815	—	128,880	—
Tuition and fees	2,924	—	4,636	—
U.S. Government	24,523	—	22,711	—
All other	63,781	—	64,381	—
Subtotal	304,318	145,036	323,753	147,931
Less allowance for doubtful accounts (primarily patient receivables)	(94,593)	(35,125)	(91,083)	(38,760)
Total	\$ 209,725	109,911	232,670	109,171

**(5) Land, Buildings, Equipment, and Books**

Components of land, buildings, equipment, and books at June 30, 2006 and 2005 are shown below:

	<b>2006</b>		<b>2005</b>	
	<b>University</b>	<b>Hospitals</b>	<b>University</b>	<b>Hospitals</b>
Land	\$ 41,117	33,093	41,890	26,415
Buildings	1,434,157	512,399	1,231,339	500,512
Equipment	291,932	317,205	259,706	302,129
Books	197,832	—	190,532	—
Construction in-progress	100,293	91,560	225,346	53,061
Subtotal	2,065,331	954,257	1,948,813	882,117
Less accumulated depreciation	(764,769)	(456,913)	(725,294)	(415,662)
Total	\$ 1,300,562	497,344	1,223,519	466,455

# THE UNIVERSITY OF CHICAGO

## Notes to Consolidated Financial Statements

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(In thousands of dollars)

### **(6) Asset Retirement Obligation**

In fiscal 2006, the University and Hospitals adopted Financial Accounting Standards Board Interpretation No. 47 (FIN 47), "Accounting for Conditional Asset Retirement Obligations." FIN 47 requires that a liability be recognized for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. Upon recognition of a liability, the asset retirement cost is recorded as an increase in the carrying value of the related long-lived asset and then depreciated over the life of the asset. The University and Hospitals' asset retirement obligations arise primarily from regulations that specify how to dispose of asbestos if facilities are demolished or undergo major renovations or repairs. The University and Hospitals' obligations to remove asbestos was estimated using site-specific surveys where available and a per square foot estimate where surveys were unavailable.

As a result of an evaluation of available asbestos remediation estimates, the University and Hospitals recorded liabilities of \$70,056 and \$7,939, respectively, for the asset retirement obligations. Accumulated depreciation was measured from fiscal 1973, the date the liability and capitalized asset would have been recognized if FIN 47 were in effect when the University and Hospitals incurred the liability. Accordingly, the capitalized asset associated with the asset retirement obligation is considered to be fully depreciated. As a result, the cumulative effect of this change in accounting principle was recorded as a non-operating reduction in unrestricted net assets in fiscal 2006.

**THE UNIVERSITY OF CHICAGO**  
Notes to Consolidated Financial Statements  
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**(7) Notes and Bonds Payable**

Notes and bonds payable at June 30, 2006 and 2005 are shown below:

	<u>Fiscal year maturity</u>	<u>Interest rate</u>	<u>2006</u>	<u>2005</u>
University:				
Fixed rate:				
Illinois Educational Facilities Authority (IEFA)				
Series 1993	2014	5.8% – 6.0%	\$ 3,300	3,625
Series 1998A	2039	5.0% – 5.3%	124,945	124,945
Series 2001A	2042	5.3%	2,860	2,860
Series 2003A	2034	4.0% – 5.3%	191,275	195,375
Illinois Finance Authority (IFA)				
Series 2004A	2035	5.0%	100,000	100,000
Series 2004C	2040	3.8%	78,677	80,000
Illinois Health Facilities Authority (IHFA) – Series 1985	2021	5.5%	61,615	61,735
Unamortized premium			2,818	2,902
Total fixed rate			<u>565,490</u>	<u>571,442</u>
Variable rate:				
Illinois Student Assistance Commission (ISAC)	2006	5.0%	66,504	86,520
IEFA:				
Series 1985 NORC	2007	3.6%	10	71
Pooled financing program	2011	3.5%	7,543	7,543
Series 1998B	2026	3.1%	90,090	90,090
Series 2001B-1	2037	3.5%	60,000	60,000
Series 2001B-2	2037	4.0%	40,000	40,000
Series 2001B-3	2037	3.8%	72,265	72,265
Series 2003B	2034	3.7%	49,076	50,000
IFA – Series 2004B	2035	3.7%	100,000	100,000
Bank line of credit (\$65,000 available)	2006	5.2%	53,000	64,800
Total variable rate			<u>538,488</u>	<u>571,289</u>
Total University			<u>1,103,978</u>	<u>1,142,731</u>
Hospitals:				
Fixed rate:				
IHFA:				
Series 2001 Serial bond	2024	5.1%	35,605	36,725
Series 2001 Term bond	2032	5.0%	28,100	28,100
Series 2001 Term bond	2037	5.1%	24,065	24,065
Series 2003 Serial bond	2015	4.0 – 5.0%	55,840	60,740
Unamortized premium			2,734	3,155
Total fixed rate			<u>146,344</u>	<u>152,785</u>
Variable rate:				
IHFA:				
Series 1994C	2027	4.0%	55,400	55,400
Series 1998	2027	4.0%	112,900	114,000
IEFA pooled financing program	2029	3.5%	56,866	27,866
Bank line of credit (\$15,000 available)			—	—
Total variable rate			<u>225,166</u>	<u>197,266</u>
Total Hospitals			<u>371,510</u>	<u>350,051</u>
Total notes and bonds payable			<u>\$ 1,475,488</u>	<u>1,492,782</u>

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

In order to reduce exposure to adjustable interest rates on variable rate debt, the University entered into a 35-year interest rate swap agreement in November 2004. The agreement has the effect of fixing the rate of interest at 3.8% for the IFA Series 2004C variable rate debt. The fair value of this swap agreement is the estimated amount that the University would pay or receive to terminate the agreement as of the consolidated balance sheet date, taking into account current interest rates and the current credit worthiness of the swap counter party. At June 30, 2006, the fair value of the interest rate swap agreement is an accrued asset of \$1,315. At June 30, 2005, the fair value of the agreement is an accrued liability of \$7,555. This financial instrument involves counter party credit exposure. The counter party for this swap transaction is a major financial institution that meets the University's criteria for financial stability and credit worthiness.

As of June 30, 2006 and 2005, the total principal amount of indebtedness considered to be legally extinguished and, therefore, excluded from the University notes and bonds payable was \$79,700 and \$81,750, respectively.

Principal payments required for University notes and bonds in each of the five years ending June 30, 2007 through 2011 are approximately \$12,821; \$11,507; \$11,434; \$13,028; and \$13,691, respectively.

Principal payments required in each of the five years ending June 30, 2007 through 2011 for the Hospitals' notes and bonds are approximately \$7,390; \$8,535; \$8,845; \$8,615; and \$8,965, respectively.

Included in the University's and Hospitals' notes and bonds payable are \$538,488 and \$225,166, respectively, of variable rate notes and bonds maturing through fiscal year 2037. In the event the University's and Hospitals' remarketing agents are unable to remarket the notes and bonds, they become a demand note and require immediate payment.

The carrying value of long-term debt does not differ materially from its estimated fair value as of June 30, 2006 and 2005, based on quoted market prices for the same or similar issues.

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

#### **(8) Collateral for Notes and Bonds Payable**

The University notes and bonds payable are secured by certain physical properties with a carrying value of approximately \$225 as of June 30, 2006. In addition, at June 30, 2006, the University had approximately \$7,950 of assets held by trustees for debt service. ISAC bonds payable are fully collateralized by student loans receivable that are fully guaranteed by the federal government.

Each of the Hospitals' IHFA bond series is collateralized and subject to certain restrictions. The Hospitals' Series 1994, 1998, 2001, and 2003 bonds are guaranteed by a municipal bond insurance policy.

Payment on the University and Hospitals IEFA Pooled Financing Program bonds is guaranteed by a bank letter of credit.

#### **(9) Securities Loaned**

The University has an agreement with its investment custodian to lend University securities to brokers in exchange for a fee. Among other provisions that limit the University's risk, the security lending agreement specifies that the custodian is responsible for the lending of securities and obtaining adequate collateral from the borrower. Collateral is limited to cash, government securities, and irrevocable letters of credit. At June 30, 2006 and 2005, investment securities with an aggregate market value of \$628,242 and \$715,708, respectively, were loaned to various brokers and are returnable on demand. In exchange, the University received cash collateral of \$539,719 and \$571,734 and noncash collateral of \$98,993 and \$160,618, at June 30, 2006 and 2005, respectively. Cash collateral is reported as both an asset and liability of the University.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

**(10) Pledges**

Pledges receivable at June 30, 2006 and 2005 are shown below:

	<b>2006</b>		<b>2005</b>	
	<u>University</u>	<u>Hospitals</u>	<u>University</u>	<u>Hospitals</u>
Unconditional promises expected to be collected in:				
Less than one year	\$ 86,060	11,438	70,293	9,455
One year to five years	138,951	20,085	126,421	8,810
More than five years	17,034	—	13,534	—
	<u>242,045</u>	<u>31,523</u>	<u>210,248</u>	<u>18,265</u>
Less unamortized discount and allowance for uncollectible pledges	<u>(57,496)</u>	<u>(4,377)</u>	<u>(46,260)</u>	<u>(480)</u>
Total	<u>\$ 184,549</u>	<u>27,146</u>	<u>163,988</u>	<u>17,785</u>

**(11) Self-insurance Liability**

The University maintains a self-insurance program for medical malpractice liability. This program is supplemented with commercial excess insurance above the University's self-insurance retention, which, for the years ended June 30, 2006 and 2005 was \$15,000 per claim and unlimited in annual aggregate. Claims in excess of \$15,000 are subject to an additional self-insurance retention limited to \$10,000 per claim and \$10,000 in annual aggregate. The Hospitals are included under this insurance program and are charged for their portion of self-insurance costs. The University and Hospitals also maintain a self-insurance program for workers' compensation and certain other liability claims.

Under the medical malpractice self-insurance program, the University makes annual contributions to a related trust fund at an actuarially determined rate that is intended to provide adequate funding of the self-insurance liability over a period of years. Actual settlements of medical malpractice claims may be more or less than the liability estimated by the University.

The medical malpractice self-insurance liability is the estimated present value of self-insured claims that will be settled in the future, and considers anticipated payout patterns as well as interest to be earned on available assets prior to payment. If the present value method was not used, the liability for medical malpractice self-insurance claims would be approximately \$41,000 higher than the amount recorded in the consolidated financial statements at June 30, 2006. The interest rate assumed in determining the present value was 6.25%.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

The estimated liability for incurred malpractice, workers' compensation, and other claims (filed and unfiled) as of June 30, 2006 and 2005 is presented below:

	2006		2005	
	University	Hospitals	University	Hospitals
Medical malpractice	\$ 162,547	—	154,907	—
Workers' compensation	3,624	6,934	3,171	7,238
Other	4,429	—	3,933	—
Total	\$ 170,600	6,934	162,011	7,238

**(12) Pension Plans and Other Postretirement Benefits**

Substantially all personnel of the University participate in either the defined contribution pension plan for academic staff or the defined benefit and contribution pension plans for nonacademic personnel. The majority of Hospitals employees participate in the University's pension plan for nonacademic employees. The University and Hospitals make annual contributions to the defined benefit pension plan at a rate necessary to maintain plan funding on an actuarially recommended basis. Based primarily on participation, the University and Hospitals share equally in contributions made to the defined benefit pension plan.

In addition to providing pension benefits, the University provides certain health care benefits for retired employees. All Medicare eligible tenured faculty who elect to participate in the University Faculty Retirement Incentive Program receive supplemental health insurance at no cost for themselves and their spouses. All other academic and nonacademic employees are entitled to supplemental health insurance coverage subject to deductibles, copayment provisions, and other limitations.

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

The obligation, funded status, and amounts recognized in the consolidated financial statements for the pension plan and postretirement plan are shown below:

	<b>Defined benefit pension plan</b>		<b>Postretirement health care benefits</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 455,920	345,322	112,975	104,723
Service cost	31,176	21,108	5,175	4,103
Interest cost	22,369	21,068	5,532	6,421
Amendments to the plan	—	910	—	—
Benefits paid	(25,104)	(23,186)	(4,344)	(4,914)
Actuarial (gain) loss, net	(80,590)	90,698	(18,455)	2,642
Benefit obligation at end of year	<u>\$ 403,771</u>	<u>455,920</u>	<u>100,883</u>	<u>112,975</u>
Change in fair value of plan assets:				
Fair value of plan assets at beginning of year	\$ 304,642	291,720	30,961	22,107
Actual return on plan assets	35,460	22,108	1,303	2,095
Employer contributions	10,000	14,000	—	11,673
Benefits paid	(25,104)	(23,186)	(4,344)	(4,914)
Fair value of plan assets at end of year	<u>\$ 324,998</u>	<u>304,642</u>	<u>27,920</u>	<u>30,961</u>
Reconciliation of funded status:				
Funded status	\$ (78,773)	(151,278)	(72,963)	(82,014)
Unrecognized actuarial loss	84,673	187,634	71,958	94,277
Unrecognized transition obligation	—	—	5,596	6,396
Unrecognized prior service cost (benefit)	8,584	9,622	(22,316)	(24,613)
Net amount recognized	<u>\$ 14,484</u>	<u>45,978</u>	<u>(17,725)</u>	<u>(5,954)</u>
Amounts recognized in consolidated financial statements:				
Prepaid (accrued) benefit cost	\$ 14,484	(34,076)	(17,725)	(5,954)
Intangible asset	—	9,622	—	—
Minimum pension liability adjustment	—	70,432	—	—
Net amount recognized	<u>\$ 14,484</u>	<u>45,978</u>	<u>(17,725)</u>	<u>(5,954)</u>

The accumulated benefit obligation (ABO) for the defined benefit pension plan was \$324,333 and \$338,718 at June 30, 2006 and 2005, respectively.



**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

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At June 30, 2005, the defined benefit pension plan ABO exceeded plan assets thus creating an unfunded ABO. This situation required the recording of a minimum pension liability adjustment of \$70,432, which is reported as a non-operating change in unrestricted net assets in the consolidated statement of activities in fiscal 2005. At June 30, 2006, plan assets exceeded the ABO eliminating the need to maintain a minimum pension liability. This situation required the reversal of the minimum pension liability adjustment recorded in fiscal 2005, which is reported as a non-operating change in unrestricted net assets in the consolidated statements of activities in fiscal 2006.

***Components of Net Periodic Benefit Cost***

	Defined benefit pension plan		Postretirement health care benefits	
	2006	2005	2006	2005
Service cost	\$ 31,176	21,108	5,175	4,103
Interest cost	22,369	21,068	5,532	6,421
Expected return on plan assets	(23,572)	(24,872)	(2,012)	(1,658)
Amortization of prior service cost (benefit)	1,038	2,426	(2,298)	(2,298)
Amortization of transition obligation	—	—	800	800
Amortization of actuarial loss	10,484	2,348	4,574	3,500
Net periodic benefit cost	\$ 41,495	22,078	11,771	10,868
Amounts included in the consolidated statements of activities:				
University	\$ 36,495	15,078	11,771	10,868
Hospitals	5,000	7,000	—	—
Total	\$ 41,495	22,078	11,771	10,868

Defined contribution pension plan costs included in the consolidated statements of activities amounted to \$31,088 in fiscal 2006 and \$26,532 in fiscal 2005 for the University and \$6,100 in fiscal 2006 and \$5,100 in fiscal 2005 for the Hospitals.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

***Actuarial Assumptions***

The weighted average assumptions used in the accounting for the pension and postretirement plans are shown below:

	Defined benefit pension plan		Postretirement health care benefits	
	2006	2005	2006	2005
Discount rate	6.4%	5.0%	6.4%	5.0%
Expected return on plan assets	8.0	8.0	6.5	6.5
Rate of compensation increase	4.2	4.2	—	—
Health care cost trend rates:				
Next two fiscal years	—	—	9.0-10.0	9.0 - 10.0
Next seven fiscal years	—	—	5.0-8.0	5.0 - 8.0
Thereafter	—	—	5.0	5.0

The expected return on plan assets assumptions for both the defined benefit pension plan and post-retirement health care benefits plan is based on historical returns for similar investment portfolios.

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects for the fiscal years ended June 30:

	2006	2005
Effect on total service cost and interest cost:		
One percentage point increase	\$ 2,330	2,295
One-percentage point decrease	(1,749)	(1,758)
Effect on year-end postretirement benefit obligation:		
One-percentage point increase	16,397	17,736
One percentage point decrease	(13,281)	(13,974)

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

***Plan Assets***

Weighted-average asset allocations by asset category are as follows:

	Defined benefit pension plan		Postretirement health care benefits	
	2006	2005	2006	2005
Domestic public equities	66 %	66 %	53 %	52 %
International public equities	20	20	—	—
Fixed income	14	14	47	48
	100 %	100 %	100 %	100 %

Plan assets for the defined benefit pension plan are managed through the Teachers Insurance and Annuity Association and College Retirement Equities Fund. The target asset allocation of 65% domestic public equities, 20% international public equities, and 15% fixed income securities are meant to result in a favorable long-term rate of return from a diversified portfolio of equity and fixed income investments. Plan assets for the postretirement health care benefit plan are managed by the University and have a target asset allocation of 50% domestic public equities and 50% fixed income securities. Typical health plans have high and variable cash needs. The asset allocation targets reflect the assumption that cash flow out of plan assets is not expected in the short-term.

***Contributions***

The University expects to make no contribution to its postretirement health care plan and no contribution to its defined benefit pension plan in fiscal 2007.

***Estimated Future Benefits Payments***

The following benefit payments, which reflect expected future service, are expected to be paid for each of the fiscal years ending June 30:

Fiscal year	Defined benefit pension plan	Postretirement health care benefits
2007	\$ 19,190	3,799
2008	19,083	4,201
2009	20,135	4,561
2010	21,328	4,848
2011	22,458	5,227
2012-2016	139,082	31,147

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

***Prescription Drug Act***

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law in December 2003. The Act provides for special tax-free subsidies to employers that offer retiree medical benefit plans with qualifying drug coverage. The University's postretirement health care plan currently meets Medicare's criteria for the tax-free subsidy because the University's plan provides for a higher level of reimbursement than Medicare. The University has recognized the effect of this subsidy in the calculation of its post-retirement benefit obligation, the impact of which is to reduce the benefit obligation by \$37,737 and \$36,076 at June 30, 2006 and 2005, respectively.

***Curtailed Pension Plan***

The Hospitals maintains a separate noncontributory defined benefit pension plan on behalf of a former affiliated organization. Prior to assumption, the benefit plan was curtailed by freezing participation and benefit accruals. At June 30, 2006 and 2005, the ABO for the plan exceeded the plan's assets thus creating an unfunded accumulated benefit obligation requiring the recording of a minimum pension liability adjustment of \$7,607 and \$(8,471) at June 30, 2006 and 2005, respectively.

**THE UNIVERSITY OF CHICAGO**

Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

**(13) Functional Classification of Expenses**

Expenses by functional classification for the years ended June 30, 2006 and 2005 are shown below:

	<b>2006</b>	<b>2005</b>
University:		
Academic and research:		
Instruction	\$ 599,662	547,553
Research	217,316	212,580
Auxiliary enterprises	110,854	104,211
Library	17,761	16,071
Student services	39,044	32,808
Operation and maintenance of physical plant	94,117	83,759
Depreciation	78,447	71,101
Interest on notes and bonds	32,793	25,894
Total academic and research	1,189,994	1,093,977
Administration:		
Institutional support	116,759	97,171
Informational services	50,221	45,604
Development	33,470	26,306
Operation and maintenance of physical plant	4,168	3,974
Depreciation	6,098	5,973
Interest on notes and bonds	1,561	1,198
Total administration	212,277	180,226
Total University	1,402,271	1,274,203
Hospitals:		
Hospital services	827,225	747,808
Total	\$ 2,229,496	2,022,011

The University's primary program services are instruction and research. Expenses reported as auxiliary enterprises, library, and student services are incurred in support of these primary program activities.

## THE UNIVERSITY OF CHICAGO

### Notes to Consolidated Financial Statements

June 30, 2006 and 2005

(In thousands of dollars)

#### **(14) Affiliated Organizations**

The University has an ongoing relationship with the National Opinion Research Center (NORC), a not-for-profit organization that conducts research in the public interest primarily for various federal agencies. The majority of NORC's board of trustees are faculty members or officers of the University. Program related revenue for the years ended December 31, 2005 and 2004 was \$97,375 and \$97,339 respectively. Unrestricted net assets at December 31, 2005 and 2004 were \$13,079 and \$10,190 respectively. In addition, the University has guaranteed \$2,271 of NORC's debt. Consolidation of this not-for-profit organization is not required because the University does not have both control and an economic interest.

The University operates Argonne National Laboratory under a contract with the U.S. Department of Energy, which provides for the payment of a fixed management allowance and an additional fee based on performance judged against established measures. The expenditures under this contract and the related reimbursements of \$482,220 in fiscal year 2006 and \$517,495 in fiscal year 2005 are not included in the consolidated statements of activities. Also, net assets relating to Argonne National Laboratory are owned by the United States government and, therefore, are not included in the consolidated balance sheets.

#### **(15) Contingencies**

Various lawsuits, claims, and other contingent liabilities arise in the ordinary course of the University's education, research, and health care activities. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on the consolidated financial position of the University.

## THE UNIVERSITY OF CHICAGO

## Statements of Activities Information – University

Years ended June 30, 2006 and 2005

(In thousands of dollars)

	<u>2006</u>	<u>2005</u>
Changes in unrestricted net assets:		
Operating:		
Revenue:		
Tuition and fees – gross	\$ 445,960	420,361
Less:		
Undergraduate student aid	(51,847)	(46,329)
Graduate student aid	(134,808)	(128,317)
Tuition and fees – net	<u>259,305</u>	<u>245,715</u>
Government grants and contracts	317,773	305,291
Private gifts, grants, and contracts	105,807	92,551
Endowment payout	176,648	176,840
Earnings on other investments	7,044	13,490
Patient care	175,569	161,873
Auxiliaries	168,770	160,725
Other income	122,521	97,907
Net assets released from restrictions	44,923	29,397
Total operating revenue	<u>1,378,360</u>	<u>1,283,789</u>
Expenses:		
Compensation:		
Academic salaries	344,814	330,129
Staff salaries	333,506	298,186
Benefits	191,919	155,398
Total compensation	<u>870,239</u>	<u>783,713</u>
Other operating expenses:		
Utilities, alterations, and repairs	43,113	39,035
Depreciation	84,545	77,074
Interest	34,354	27,092
Supplies, services, and other	334,665	318,312
Insurance	35,355	28,977
Total other operating expenses	<u>532,032</u>	<u>490,490</u>
Total operating expenses	<u>1,402,271</u>	<u>1,274,203</u>
Excess (deficiency) of operating revenue over expenses	<u>(23,911)</u>	<u>9,586</u>

## THE UNIVERSITY OF CHICAGO

## Statements of Activities Information – University

Years ended June 30, 2006 and 2005

(In thousands of dollars)

	<u>2006</u>	<u>2005</u>
Changes in unrestricted net assets:		
Nonoperating:		
Investment gains	\$ 561,219	425,294
Minimum pension liability adjustment	70,432	(70,432)
Loss on debt refinancing	—	(8,998)
Other, net	27,803	(13,108)
Cumulative effect of the change in accounting for asset retirement obligations	(70,056)	—
Change in unrestricted net assets from nonoperating activities	<u>589,398</u>	<u>332,756</u>
Increase in unrestricted net assets	<u>565,487</u>	<u>342,342</u>
Changes in temporarily restricted net assets:		
Private gifts	97,001	77,563
Endowment payout	286	285
Investment gains	1,936	3,556
Other, net	(31,325)	(9,393)
Net assets released from restrictions	(44,923)	(29,397)
Increase in temporarily restricted net assets	<u>22,975</u>	<u>42,614</u>
Changes in permanently restricted net assets:		
Private gifts	42,053	44,086
Endowment payout	1,853	1,728
Investment gains	3,837	2,343
Other, net	25,482	6,544
Increase in permanently restricted net assets	<u>73,225</u>	<u>54,701</u>
Increase in net assets	661,687	439,657
Net assets at beginning of year	<u>4,628,497</u>	<u>4,188,840</u>
Net assets at end of year	<u>\$ 5,290,184</u>	<u>4,628,497</u>

See accompanying independent auditors' report.



## THE UNIVERSITY OF CHICAGO

## Balance Sheet Information – University

June 30, 2006 and 2005

(In thousands of dollars)

<b>Assets</b>	<b>2006</b>	<b>2005</b>
Cash and cash equivalents	\$ —	—
Notes and accounts receivable	209,725	232,670
Collateral held for securities loaned	539,719	571,734
Prepaid expenses and other assets	27,190	21,012
Pledges receivable	184,549	163,988
Investments	5,264,022	4,678,865
Land, buildings, equipment, and books	1,300,562	1,223,519
Total assets	<u>\$ 7,525,767</u>	<u>6,891,788</u>
<b>Liabilities and Net Assets</b>		
Liabilities:		
Accounts payable and accrued expenses	\$ 207,120	246,218
Deferred revenue	76,703	73,728
Payable under securities loan agreements	539,719	571,734
Assets held in custody for others	31,199	27,347
Self-insurance liability	170,600	162,011
Asset retirement obligation	69,200	—
Notes and bonds payable	1,103,978	1,142,731
Refundable U.S. Government student loan funds	37,064	39,522
Total liabilities	<u>2,235,583</u>	<u>2,263,291</u>
Net assets:		
Unrestricted	4,004,574	3,439,087
Temporarily restricted	351,993	329,018
Permanently restricted	933,617	860,392
Total net assets	<u>5,290,184</u>	<u>4,628,497</u>
Total liabilities and net assets	<u>\$ 7,525,767</u>	<u>6,891,788</u>

See accompanying independent auditors' report.